Distinguishing Charges for Service from Taxation
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When Does a Charge for Service Become a Tax? Iowa's courts and the Attorney General's office have grappled with this question on numerous occasions. In fact, the Supreme Court of Iowa most recently addressed this issue in its May 2006 decision pertaining to the validity of the gas and electric franchise fees charged by the City of Des Moines. *Kragnes v. City of Des Moines*, 714 N.W.2d 632 (Iowa 2006). While the Court did not determine that the franchise fees were an illegal tax, the Court did reject the City's argument a legitimate franchise fee could exceed the cost of regulation and require the City to justify the franchise fees based upon the City's costs. The City is in the process of preparing documentation and will need to demonstrate the franchise fees do not exceed the direct, indirect, and/or incidental expenses involved in providing the service. The Polk County District Court has been directed to review this case.

In other cases, the Courts have also held the fees and charges for the services provided by local governments may not exceed the cost of providing the services. The following quote from the Iowa Supreme Court decision in *Home Builders Assn' of Greater Des Moines v. West Des Moines*, 644 N.W.2d 339, 347-48 (Iowa 2002) provides some clarification of the distinctions between taxes and fees:

> "Having examined the sources and scope of the City's taxing authority, we now examine its authority to charge fees under its police power. Before municipalities had home rule authority, this court had interpreted the regulatory authority granted by statute to cities to include the power to charge a fee to meet the expenses of the city in exercising its regulatory authority. *Felt v. City of Des Moines,* 247 Iowa 1269, 1273, 78 N.W.2d 857, 859 (1956) (holding that fee charged to cover city's expenses in exercising its statutory authority was "a proper incident to the authority granted under the statute"); see *City of Pella v. Fowler,* 215 Iowa 90, 98, 244 N.W. 734, 738 (1932); *Solberg v. Davenport,* 211 Iowa 612, 617, 232 N.W. 477, 480 (1930). The same principle applies with respect to a city's home rule authority: a city may charge a fee to cover its administrative expenses in exercising its police power. Thus, the reasonable cost of inspecting, licensing, supervising, or otherwise regulating an activity may be imposed on those engaging in the activity in the form of a license fee, permit fee, or franchise fee. See *City of Hawarden,* 590 N.W.2d 504, 506-07 (Iowa 1999). In addition to regulatory fees, a municipality may charge a citizen when it provides a service to that citizen. See *Newman,* 232 N.W.2d 568, 573 (Iowa 1975).
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> The rather narrow range of fees permitted by our cases is consistent with our long-standing definition of a tax. As noted above, a tax is "a charge to pay the cost of government *without regard to special benefits conferred.*" *In re Shurtz's Will,* 242 Iowa 448, 454, 46 N.W.2d 559, 562 (1951) (emphasis added). Consistent with this definition, the regulatory and service fees permitted under Iowa law are based on a special benefit conferred on the person paying the fee. In the regulatory context, fees enable the government to administer a particular activity or occupation to the peculiar benefit of those engaged in that activity or occupation. Therefore, fees designed to cover the administrative expense of regulating a particular activity, occupation, or transaction are not taxes. Similarly, when one pays for a service such as admission to the municipal swimming pool, one has received a special benefit--admission to the pool--and so the admission fee is not a tax."

In addition, Attorney General's opinions have been issued with similar conclusions on fees and taxes. An Attorney General's opinion dated April 26, 1993 concludes "Construction and maintenance of a toll road by a county for the purpose of raising revenue would amount to the imposition of a tax. There is no statutory authority, either express or implied, to impose such a tax, and therefore, such a tax may not be levied." 1994 Iowa Op. Att'y Gen. (#93-4-7).

Another Attorney General's opinion dated May 4, 1979 concludes "The county board of supervisors may issue a permit to and collect a permit fee from quarry operations pursuant to the County Home Rule Amendment, as long as the permit fee is reasonable and related to the expense of administration. However, if the purpose or the effect of the fee is to raise revenue beyond the administrative costs of permit system itself, the fee would be a tax and be in contravention of the County Home Rule Act." 1980 Iowa Op. Att'y Gen. 154 (#79-5-6).

While we don't yet have a definitive answer as to what may or may not be appropriately included in "indirect" or "incidental" costs, the outcome of the Des Moines franchise fee case will clearly impact how local governments charge for services such as franchise fees or building and other types of permits issued by local governments. Hopefully, this case will also provide guidance on how local governments should document the costs associated with providing services and will most likely result in a compliance area considered during local government audits.

It is important for a local government to recover the costs associated with providing services. However, from an accountability standpoint, it is equally important for a local government to demonstrate the revenue collected from these charges does not exceed the cost of providing the services and thereby become an illegal tax. With the fiscal 2008 budget process soon to start, local governments would be well advised to evaluate and consider charges for service, fees and permits issued in relation to the direct, indirect, and incidental costs to provide the services.